Laurus
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Don't gamble; take all your savings and buy some good stock and hold it till it goes up, then sell it. If it don't go up, don't buy it.

… Will Rogers

I recently read an article that compared investment marketing to the manufacture of fishing lures. The comparison, so the article goes, is that the lure is really designed to attract fishermen and not their prey – which is consistent with the "marketing spin" put on investing to consumers. Interestingly, when we were discussing the article, Linda uncovered its roots may have been a presentation to the USC Business School in 1994 by Charlie Munger.

Good investing is boring. There is no "flash" to a strong investment team as the process is really time-proven and repetitive. The Will Roger's quote above may seem trite, but good managers actually do strive to find stocks that will go up over time – more importantly, they try to avoid buying stocks that go down.

Unfortunately, good management processes do not lend themselves to the short-termism of the buyer. To this point, we recently were interviewed by one of Canada's larger pension funds. During the interview, the plan manager told us they were tiring of measuring performance over long periods and had moved to evaluating their equity managers on a much shorter-term basis; in this case, a rolling three year time frame.

This is a complete dislocation from the principles of sound investment management and attention on near-term performance. It ensures the investment managers hired to manage equities will be forced to pay attention to stock price momentum to avoid early termination, likely deviating away from the reason they were hired – the strength of their investment process. It will also ensure the pension plan manager will be required to take one of two tacks when explaining results to the Board; either a) why there is such significant manager turnover (which is very costly to the plan), or b) why performance volatility has risen significantly.

The evaluation of manager "skill" simply by measuring performance is fraught with danger. All management processes – good and bad – underperform their peers at some time or another; in the former case, decisions have yet to bear fruit while, in the latter case, through simply bad decision-making. So how does the investor uncover good investment skill?

Michael Mauboussin in his book "*The Success Equation: Untangling Skill and Luck in Business, Sports, and Investing*" discusses the distinction as a continuum of activities with skill at one end and luck at the other. He contends that both skill and luck are contributing to performance; the real question is in what proportion. We tend to associate good outcomes simply to good skill when, in fact, luck plays a part. Similarly, bad outcomes are not necessarily associated with bad skill.

Understanding the process is the best determination of manager skill. Assuming full transparency, a manager should be able to explain how a particular position evolved into the portfolio and the expectations for the investment. Working closely to understand why each investment evolved, the investor can then build a simple understanding on how the investment process worked. How do you know intuitively if the process is any good?

Mauboussin suggests that if it a) has worked over time, b) is analytical, in that it identifies situations other investors are unaware of, c) takes into account cognitive biases, and d) is free from organizational or institutional bias, the process is sound.

All managers will make mistakes – investing is a difficult task. We believe the primary distinction in investing success is looking for mispriced opportunities. Therefore a clear distinction between the fundamentals we uncover and the expectations of the "street" provide the foundation for strong, long-term investment success.

Investment interviews with new clients are typically referred to as "beauty contests" – low on substance and high on flash. To avoid being captivated by the fishing lure, look to the manager's ability to protect and grow capital – by any definition that is good investment skill.

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